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**CHANGING THE CAPITAL:
Innovation in London's Small Firms**

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ABSTRACT

A considerable body of literature has emerged in recent years that has documented the increasing importance of innovative practices in UK small firms. Much of this literature has developed in response to reports of under-performance by UK firms in innovative practices compared with other countries. This paper asserts an inextricable link between innovation and marketing and seeks to generate a clearer picture of characteristics of both innovative owner-managers and businesses. Using a sample of 233 small and medium sized businesses in Greater London, original data is presented and archetypes of innovative entrepreneurs and businesses are developed. The typical innovative business owner is shown to be young to middle aged, risk taking and embracing of new technologies. The typical innovative business is shown to be young, in the start-up stage of business development and using current business plans and marketing plans. An understanding of these archetypes and concerns regarding the measurement and understanding of innovation and small firms are discussed.

Keywords

Innovation, London, owner demographics, entrepreneurial archetypes, small business growth

INTRODUCTION

The study of the processes of innovation is a major contributor to research at the marketing/entrepreneurship interface because it is a key topic in the literature of both disciplines. Innovation is seen as a central tenant in the development of effective business strategies by both entrepreneurship and marketing commentators (Hills and Hultman, 2005). It is a necessary part of entrepreneurial behaviour (Drucker, 1994), and an essential step in the marketing process of meeting customer needs in a competitive market through product/service development (Jobber, 2004). The role of innovation in the small firm has come under renewed scrutiny following evidence that it has a significant impact not only on the growth of the firm but also on the performance of regional and national economies. Evidence suggests that innovating companies grow faster than non-innovators, and sustain a higher performance through productivity improvements (Oke et al, 2004). Geographic regions benefit from the presence of innovative firms through higher productivity and economic growth. In the UK, a number of policies and initiatives promote innovative practices amongst small businesses (DTI, 2003).

There is growing evidence that innovation does not just happen by chance but can be encouraged through a systematic and rigorous approach. The innovative small business is one that is alive to change and flexible in its approach. This aspect of innovation is captured in Peter Drucker's (1994) observation that:

“Innovation is the specific tool of entrepreneurs, the means by which they exploit change as an opportunity for a different business or service. It is capable of being presented as a discipline, capable of being learned, capable of being practiced.”

(p.10)

Innovation, it would seem, is highly significant to business prosperity and can be managed systematically and pro-actively. However, as a term it is often used without clarity. It is a concept that can be thought of and used in fundamentally different ways. Three main conceptualisations have been put forward to encapsulate some of these differences (Tether, 2003). First, innovation can be taken as *achievement*, involving significant advances in the use of technology or novel ways of overcoming existing problems. Secondly, innovation is used to describe the *consequences* of such achievements. ‘Great’ innovations have the potential to make a significant impact on a business or on society. The impact is often unintended and beyond the expectations of the innovator. Thirdly, innovation can be taken to mean the *capacity to change* - the attribute that allows entrepreneurs to exploit change as an opportunity for a different business or service. In this sense, a distinction is made between the chance event or discovery and the systematic management of change. The innovative small business is one that is alive to change and flexible enough to respond to it because the entrepreneur has the ability and willingness to learn.

Drucker (1994) identified the practice of innovation as a specific tool of the entrepreneur, an action-oriented process in which change is the focus of thinking, and opportunities for new products and services are identified and exploited. Views such as Drucker’s have been adopted in principle by policy makers in the UK. The Department of Industry’s Innovation Review defined innovation as;

“...the successful exploitation of new ideas... and involves the creation of new designs, concepts and ways of doing things, their commercial exploitation, and

subsequent diffusion through the rest of the economy and society.” (Innovation Review, 2003, p19)

This definition provides an understanding of innovation as a business practice that encompasses a wide range of processes from idea generation and opportunity recognition through to commercialisation and improvements to business performance and competitiveness. This can be applied in businesses of all sizes and sectors, but the role of innovation in smaller firms is seen to be particularly significant as a source of product and process development, and a means of improving competitiveness. This is emphasised in the field of marketing where a contrast has been drawn between ‘entrepreneurial marketing’ which has a focus on innovation in products/services and strategies whilst ‘traditional marketing’ is more concerned with modifications to existing products and strategy (Hills and Hultman, 2005).

However, whilst the Innovation Review provides a useful foundation for a universal understanding of innovation at a practitioner level, it does not address questions concerning how innovative practices are best measured for the purpose of research.

The measurement of innovation amongst SMEs is particularly problematic. Hoffman et al. (1998) highlighted the fact that little is known about the number of SMEs involved in innovative activity, nor the nature of that activity. Amongst small firms innovation is often ad hoc and often under-reported because SMEs do not necessarily innovate in formally recognised ways (Hoffman et al., 1998; Hughes, 2002). Despite this, Hughes (2002) points to a dichotomy of measurement techniques, differentiating between ‘inputs’ and ‘outputs’. Inputs include expenditure on R&D and measures of the staff employed in R&D, whilst ‘outputs’ refer to patents, measures of incidence of product, process and logistic innovations. The London Annual Business Survey (LABS, 2003) used the latter

definition when measuring innovation behaviour across a large sample of London businesses, drawing up a 4-way schema that categorises businesses based on their behaviour in the introduction of significantly enhanced products or processes. Such a measure is simplistic but does at least allow for the investigation of a large number of SMEs. Further complications to our understanding of innovation processes are that they are a dynamic and vary by firm type and industry, rather than steady state, uniform activities across all sectors (Schwartz and Teach, 2001; Hanson and Hills, 2004).

The increased attention to innovation as a business practice in the UK can be attributed to two factors: first its function in improving the competitiveness and enhancing the profitability of individual businesses; secondly the relative under-performance of UK firms, particularly small ones, compared particularly to the USA and other European countries (UK Innovation Survey, 2001).

In support of the first factor, a considerable body of literature now suggests that an active involvement in innovative practices is positively correlated with increased productivity and turnover (Hughes, 2002; LABS 2003; UK Innovation Survey, 2001). The importance of innovation to business ventures is taken further by Kuczmariski (2002) who views innovation as the single most important factor in the future growth of any business venture. Drucker (1994) sees innovation as the means through which companies are set apart from their competitors and realise their potential for future profitable growth. An example of this can be seen by following the argument of Peters (1984) that superior business performance is achieved through total customer satisfaction which, in turn, is brought about by continuous innovation (Salavou, 2004).

Some express concern that the influence of innovation can be exaggerated. Storey (1994) and Oakey (1993) found no clear indications of direct links between innovative activity

and improved business performance and profitability. However there is substantial research evidence to suggest that SMEs in a variety of sectors do engage in innovative activities and that these activities are likely to be important determinants of their success (Keeble, 1992; Moore, 1993, Joyce et al, 1994).

The second factor that has increased awareness of innovation practices is the reported under-performance of UK firms in this field. The Innovation Review reports that, although the UK is on a par with the EU average, it is well behind rivals like the US, France and Germany:

“Overall UK innovation performance appears to be, at best, average compared to our major competitors. This is reflected in the large productivity gap which exists between the UK and its major competitors.” (Innovation Report, 2003, p19)

There are a number of reasons cited in the literature for this poor performance including the level of owner-manager skills and the resources available to them. In reporting relatively low levels of innovative activity in the UK, the 2002 Global Entrepreneurship Monitor (GEM, 2003) identified owner-manager attitudes and access to the knowledge base as key barriers to innovation. The 2003 GEM report did indicate improvements in some of the innovation measures, including an increase in the number of new products/services, the percentage spent on R& D and collaborations with research partners (GEM, 2004). However, access to specialist knowledge in higher education and research institutes is seen as a key to innovation and according to GEM (2004) lack of SME access to this knowledge base is still a major failing in the UK. It also suggests that innovation is more prevalent amongst certain owner-managers and certain business sectors. To an extent this is borne out with evidence from the LABS (2003) report that suggests that innovation was mostly related to the purchase of machinery and equipment

and that only about a fifth of London firms had a designated R&D spend. Hughes (2001) points out that innovation is not just about the development or use of technology; enterprises can also innovate in changing business strategies to make them more competitive, for example in developing marketing strategies, the use of e-commerce, knowledge transfer and the employment of graduates.

London, it seems, has an even worse innovation record than the rest of the UK. Evidence suggests that, despite an impressive economic performance by the London economy, innovation within the capital is below the average of neighbouring regions. The UK Innovation Survey reports that only 44% of London SMEs are ‘innovation active’, compared with 46% across England. There are, however, different levels and intensity of innovation between regions and, indeed, sectors. The UK has some strong sectors, such as pharmaceuticals, aerospace, biotechnology, financial services and creative industries (Innovation Review, 2003). Both these findings suggest scope for policy action to promote dissemination of best practice from high to lower performing regions. Given the definitions and issues raised in the literature regarding the importance of innovation and the under-performance of UK firms, this paper seeks to identify archetypal ‘innovative’ businesses and owner-managers.

METHODOLOGY

The survey was conducted as part of a wider investigation of small and medium sized businesses in London by the Small Business Research Centre at Kingston University for Workspace Group, a commercial property company specialising in providing small-unit business space to small businesses across London. The largest specialist provider of business space in the capital, Workspace Group has more than 4,000 small business

customers in over 100 properties across Greater London. The investigation sought to identify owner-manager and business characteristics, key business performance indicators, and self-reported owner-manager styles, in addition to the extent of involvement in innovative practices.

At the exploratory stage of the research, a number of in-depth interviews were conducted during Autumn, 2003 with small business owners in order to shape the nature and content of the questionnaire. The exploratory interviews were used to explore a number of performance indicators. Interviews were conducted face-to-face allowing the researcher to be flexible and clarify any potential ambiguities. In addition, a detailed exploration of existing research was undertaken to establish reported trends in owner and small business populations. Identified trends were influential in shaping the empirical research that followed.

A postal questionnaire was distributed to 2,487 small and medium-sized enterprises across the Greater London region in Spring 2004. The sample used was that of the Workspace Group tenants who are, by definition, all firms that occupy business premises, so that the sample can be considered to include only 'mainstream' businesses. The questionnaire was designed to identify specific characteristics of business owners and their businesses and to make comparisons with the wider small business population. Therefore, a significant number of questions replicated those used in other research studies. Two studies in particular were used: the London Annual Business Survey of SMEs in London (LABS 2003) and Kingston University Small Business Research Centre's study of SMEs in South England (Blackburn and Stokes, 2003).

Analysis was conducted in two stages – bivariate and multivariate. The bivariate analysis serves the purpose of an investigation between two nominal variables and utilises the chi-

square test of association as a test of statistical significance. It is the results of this analysis that are presented here.

A total of 233 questionnaires were returned, representing a response rate of 9.4%.

Although this sample presents good opportunities for analysis as a single group, its size does present issues of representation particularly when data is broken down into sub groups. In particular it did not provide robust data for analysis by sector and legal type of firm. The majority of the respondents were from the creative industries and two thirds were limited companies, and analysis by type of industry and legal type of firm revealed no significant differences (at the $p < .05$ level). Non-response could also affect the validity of the research if there are reasons why one group of tenants are more likely to reply than others. It was not possible to check for non-response bias as follow up telephone calls were unsuccessful in producing results. The qualitative research prior to the questionnaire did not reveal any substantive reasons for potential response bias. However, as with most research, the most valid insights from this survey come not from single points of data but from multiple sources where several responses indicate the same conclusion.

RESULTS & FINDINGS

The demographic characteristics of the sample were similar to the mainstream small business population. 81.4% of respondents were male compared with populations in wider surveys of 79% (LABS, 2003) and 73% (Kingston Smith, 2002). In relation to age and educational qualifications, the sample was evenly spread, 35.8% were less than 39, 34.1% between 40 and 49 and 30.1% are 50 or older. Though there is a slight skewing toward younger owner-managers, the distribution of the sample is more or less consistent with previously reported findings (Kingston Smith 2002; LABS 2003). The sample had a

higher than average educational status, with 46.6% having been university educated and a further 24.3% having a professional or equivalent qualification. The high proportion of university-educated owner-managers is, to some extent, not surprising as it follows a rising pattern of improving educational levels amongst the younger generation who are well represented across the sample.

With regard to the businesses that comprise the sample, the distribution across business sectors can be seen in Exhibit 1 below. Notable are the high proportions of professional and business-to-business services. In fact, if all ‘business services’ are taken as a single group, they comprise nearly 60% of the entire sample. About two-thirds (64.9%) of the sample are organised as private limited companies and a further quarter (24.6%) as sole proprietorships. There is a good distribution of business ages in the sample with nearly equal proportions of businesses aged between 1 and 4 years old (28.8%), 5 and 9 years old (27.5%), and 10 and 19 years old (29.3%). The median age of businesses across the sample is 8 years old denoting businesses that are established and potentially looking for expansion. Indeed many respondents (57.7%) categorised their stage of business as ‘going for growth’. The size of the businesses measured by number of employees and turnover can be seen, with comparisons, in Exhibits 2 and 3. Businesses in the sample have a median turnover of £250,000 and typically have 3.5 employees in addition to the owner. Response rates to several of the questions were low (see for example Exhibit 3 below) because the questions were asking for commercially sensitive information such as turnover and profits.

[INSERT EXHIBITS 1, 2 & 3 HERE]

The introduction of new products and services represents a key indicator of business innovation and serves as a crucial source of improvement in productivity (LABS, 2003). There is evidence to suggest that innovative companies are the most successful (Keeble, 1992; Moore, 1993; Joyce et al, 1994). To gain an insight into respondents' innovation behaviour they were asked to indicate whether or not they had been involved in innovative practices over the last 12 months. Innovative practices were defined as the introduction of a new or significantly enhanced product/service or process/practice. Although this is a simplistic measure, it replicated the question used by LABS (2003) and thus facilitated comparisons to the wider population of SMEs in London. The contrast between answers to this question in the two surveys was marked. In this research, 41.2% had introduced a significantly enhanced product or service over the last 12 months and 44.2% had introduced a significantly enhanced process or business practice over the same period. This compared with only 25% of the LABS survey in both instances.

The response to the two previous questions allows for the development of a matrix that categorises the attitudes of owner-managers from across the sample. Figure 1, below, identifies those who have introduced both new products and processes as '*Innovators*', contrasted to '*Conservatives*' who have done neither, and '*Changers*' who have introduced one or the other but not both.

[INSERT EXHIBIT 4 HERE]

Using this schema, 31.8% of the sample can be categorised as '*Innovators*' and 21.9% as '*Changers*'. This compares favourably with results reported by LABS, which records

15% as ‘Innovators’. Exhibit 5, below, shows the full results. An issue in the LABS survey is that no differentiation was made between the *product/service Changers* and the *practice/process Changers*. In this research the categories were recognised as potentially different and labelled Changers 1 (practices/processes) and Changers 2 (products/services). However in the analysis below of characteristics and behaviours, no significant differences were found between the two types of Changers at $p < .05$.

[INSERT EXHIBIT 5]

An analysis was conducted looking for statistically significant relationships between a range of owner-manager and business characteristics and innovation behaviour. The results that follow identify key characteristics of the archetypal, or typical, innovative owner-manager and small business. Reported results are significant at $p < .05$.

- **Age of Owner-manager:** Owner managers aged between 30 and 39 are the most likely to be Innovators and the least likely to be Conservatives ($p=0.016$). 45.7% of this age group are categorised as ‘innovators’;
- **Education of owner-manager:** Interestingly, 44.4% of those with no formal qualifications were categorised as Innovators compared with 41.7% of university educated respondents ($p=0.012$);
- **Age of business:** The age of the business is a key predictor of innovative behaviour. Exactly half of all business aged between 1 and 4 years old were ‘Innovators’, a

third of those between 5 and 9 years old (33.3%) and about a quarter of business between 10 and 19 years old ($p=0.000$). There is a definite pattern of innovation decreasing as the age of the business increases;

– **Business stage:** The above is mirrored to a certain extent by the results for business stage. 57.1% of all start-ups, 42.9% of early stage, 35.1% going for growth businesses were categorized as Innovators ($p=0.002$);

– **Business planning:** The results suggest that formal planning procedures are important to innovation. Businesses that have a current business plan (43.9%) and those with a current sales and marketing plan (46.7%) are more likely to be Innovators than those without ($p=0.003$ and $p=0.000$);

– **Management style:** 39.1% of all business owners who categorised their business style as ‘risk taking’ are Innovators, compared with only 24.4% who indicated that they preferred to avoid risks ($p=0.004$) and 38.0% of all business owners who indicated that they like to use new technologies as soon as possible are Innovators, and is in contrast to those who wait for systems to be tried and tested before using them (27.6%; $p=0.006$);

– **Adoption of new technologies:** More than half of those who described themselves as an ‘Innovator’ when it comes to the adoption of new technologies (51.9%) can also be categorised as an ‘Innovator’ based on their innovation behaviour ($p=0.014$);

From previous research (e.g. Schwartz and Teach, 2001; Hanson and hills, 2004), differences by firm type might be expected. However, the findings above were the only significant relationships that were found at the $p < .05$ level.

From the findings above, archetypal 'innovative' owner-managers and small business have been compiled and can be seen below in Exhibit 6.

[INSERT EXHIBIT 6 HERE]

DISCUSSION & CONCLUSIONS

The results show an above average level of innovation of about twice the levels reported by LABS (2003). This addresses some of the concerns regarding the number of innovating SMEs in the UK (Hoffman et al, 1998). The analysis of these results permits the development of innovation archetypes, as presented above. The findings suggest that age, education and management style are key indicators of innovative owners. Typically, the innovative owner-manager is aged between 30 and 39 and either has no formal qualifications or is university-educated. More indicative is that the innovative owner-manager considers his/her business style as 'risk taking', that they like to use new technologies as soon as possible and they are innovative in the adoption of new technologies. This is consistent with conventional definitions of innovation that focus on introducing new initiatives and taking advantage of new technologies. It is also interesting to note that there was no reported relationship between innovation and gender or ethnicity.

The archetypal business emerges as between 1 and 4 years old and in the 'start-up' phase of business development. The apparent strength of the relationship between age of the

business and innovation behaviour implies that the propensity of a business to be innovative decreases as the business matures. This is also supported by the findings relating to business stage. This supports earlier research and anecdotal evidence that owners frequently innovate to start a business but later become more 'managerial' than entrepreneurial once their venture is established (Hargadon, 2003). Innovation can become stifled by organized management behaviour that thrives on order not uncertainties. Policies and rules are needed as a firm grows, but these can restrict the creative thinking that underpins innovative activities.

This slowing in the pace of innovation with the age of the business presents a potential dichotomy for policy makers. Several government initiatives (e.g. the Small Business Loan Guarantee Scheme in the UK) are aimed at helping businesses survive for longer.

But the implication from this research is that artificially prolonging the lifespan of a business restricts the likelihood of business innovation. There is clearly a need to investigate further the barriers to innovation associated with more mature businesses.

Other surveys and research have pointed to an under-performance by UK firms in innovation practices, especially when compared with other countries. However, this research indicates a much more innovative business base than other regional research especially LABS (2004). This raises some interesting points. First, statistics that give 'average' figures of innovation can be misleading because despite a poor overall innovation record, innovative firms are disproportionately represented across regions and business sectors. Secondly, there is the possibility of a clustering of like-minded entrepreneurs, so that pockets of highly innovative firms are created as illustrated by this research.

The development of archetypes is contentious, but it is felt that the identification of typical innovators and innovative businesses provides a useful foundation for further research. For example, it is notable that innovative business owners tend to use both a current business plan and a marketing plan, suggesting that business owners structure and plan innovation. It is therefore possible that they are more likely to use a structured and planned approach to recording innovations, whilst those using less structured practices are more likely to omit innovations from survey measurements as they have not been recorded.

As the literature has shown, there is a need for further consideration as to how innovation is measured. This study has used a self-reporting process by which respondents are asked to indicate whether or not they have introduced a new good/service or process/practice over the last 12 months. Whilst this represents a useful indicator of innovation behaviour and allows for a pan-London comparison, it almost certainly under reports the extent of innovation amongst small firms. This highlights the need for more sophisticated measures of innovation that factor in the level, frequency and impact of innovation behaviour amongst small firms. Such measures would be helpful in providing an explanation for the apparent under-performance of UK firms in innovation at a time when the overall economic performance has been strong.

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Exhibit 1: Business sector

	n	(%)
<i>Building & Construction</i>	19	8.9
<i>Professional Services</i>	63	29.6
<i>Publishing & Media</i>	24	11.3
<i>Manufacturing &</i>	25	11.7
<i>Other services</i>	38	17.8
<i>Other</i>	44	20.7
	213	100.0

Exhibit 2: Number of employees

	n	(%)
<i>1-4</i>	<i>140</i>	<i>30.1</i>
<i>5-9</i>	<i>49</i>	<i>21.0</i>
<i>10-24</i>	<i>20</i>	<i>8.6</i>
<i>25-49</i>	<i>14</i>	<i>6.0</i>
<i>50-99</i>	<i>3</i>	<i>1.3</i>
<i>100+</i>	<i>4</i>	<i>1.7</i>
	<i>230</i>	<i>100.0</i>

Exhibit 3: Business Turnover

	n	(%)
<i>Up to £100,000</i>	<i>62</i>	<i>33.0</i>
<i>£100,001-£500,000</i>	<i>66</i>	<i>35.0</i>
<i>£500,001-£1,000,000</i>	<i>16</i>	<i>16.0</i>
<i>£1,000,001+</i>	<i>16</i>	<i>16.0</i>
		<i>100.0</i>

Exhibit 4: Innovation Matrix

		Introduced new or significantly enhanced products or services	
		Yes	No
Introduced new practices or processes	Yes	Innovators: have introduced both new products and services and new business processes and practices.	Changers (1): have not introduced new products or services, but have introduced new business practices or processes.
	No	Changers (2): have introduced new products or services, but have not introduced new business practices or processes.	Conservatives: have not introduced new products or services or new business processes or practices.

NB a small number of respondents did not know whether they had introduced a new product/service or process/practice. These responses have thus been omitted.

Exhibit 5: Innovation Matrix Results

	%	LABS (%)
Innovator	31.8	15
Changer	21.9	20
Conservative	46.4	63
Don't know	—	2

Exhibit 6: Archetypal ‘innovative’ owner-manager & small business

Archetypes

<i>Owner-Manager</i>	<i>Business</i>
Aged between 30 and 39 No formal qualification/ University educated Consider themselves a ‘Risk taker’ Uses new technologies as soon as possible Innovative in adopting new technologies	1-4 years old Start-up Has current business plan Has current marketing plan